IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT

In the Matter of PETER THOMPSON, Bankrupt. R. D. SIMPSON, Trustee of the Estate of PETER THOMPSON, Bankrupt, *Petitioner,* —vs.— L. H. MACOMBER, Receiver of the PETER THOMPSON COMPANY, a Corporation, *Respondent,*	No. 3433

PETITION FOR REVISION

PETITIONER'S BRIEF

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STATEMENT OF THE CASE.

Peter Thompson, bankrupt herein, filed his voluntary petition in the District Court of the United States for the Western District of Washington and was duly adjudicated in April, 1917.

On April 2, 1918, one L. H. Macomber as receiver of the Peter Thompson Company, a corporation, filed in the bankruptcy proceedings a claim based

upon an alleged liability growing out of the subscription of Peter Thompson to the capital stock of the Peter Thompson Company, which had been found by the Superior Court of King County, Washington, to be "approximately $8,500.00". The trustee interposed certain objections (pp. 95-96). These objections were treated in the nature of a demurrer and sustained by the Referee (pp. 105-108). On a review of the Referee's decision by the District Court the Honorable Referee was overruled (pp. 113-19), the District Judge ordering "that the order of the Referee sustaining the objections treated as a demurrer interposed by the trustee", is referred back to the Referee for further proceedings not inconsistent with this order, etc.

The trustee thereupon, under the assumption that he would be entitled to contest the claim of the said Macomber upon its merits, by taking of testimony, etc., interposed further objections (pp. 121-126). Thereupon the said Macomber moved to strike all of the objections, numbered 1 to 6, inclusive (pp. 126-127). This motion was denied by the Referee (p. 128), and upon review to the District Court the Honorable Referee was again reversed, the District Judge making the following order: "The motion of the claimant, L. H. Macomber, to strike each and every one of the grounds of objection, set forth by the trustee, having been considered separately upon the merits of said respective grounds, said motion of claimant was sus-

tained and the ruling and the decision of the Referee in respect thereto was reversed" (pp. 130-131).

Subsequently thereto the District Judge made an order directing that the claim of said Macomber as receiver be allowed as filed (pp. 132-134).

ARGUMENT.

It was the contention of the trustee below, and it is here, that the claim of said Macomber is not entitled to participate in the estate of the bankrupt for six different reasons (pp. 120-6).

It will be observed that the trustee at no time or place has had the opportunity to contest the claim of the said Macomber on its merits. His objections in the first instance were treated as a demurrer, and as such were overruled by the District Court. When the trustee interposed further objections involving questions of fact a motion to strike the same was interposed by the attorney for the receiver, and an order was made by the District Judge striking each and every one of them. No opinion was filed by the District Judge, but the motion to strike was sustained on the ground of

(a) The decision of the District Judge on the demurrer that had been interposed previously; and

(b) On the assumption that the findings and decree of the Superior Court of King County were binding and conclusive.

It will be seen, therefore, that there is involved herein questions of law only.

The rulings of the District Court complained of are set forth in the Petition for Revision (pp. 143-7) and numbered (a) to (f), inclusive. We will discuss them in order.

I.

The claim appears to be based upon an order made by the Superior Court Judge of King County, Washington, on the 23d day of March, 1918. This is entitled, "Order Appointing Time for Hearing Petition for Call and Assessment" (p. 122). The making of such an order is in conformity with the practice and law of Washington and, as we understand it, in conformity with the law and practice of most of the States of the Union. It is fundamental and well established that a receiver of an insolvent corporation may apply to the court for an order directing stockholders to pay their unpaid subscriptions where there is a *prima facie* liability, and that in the event certain stockholders do not pay or do not respond to the order of court the receiver may be further authorized to institute an action to compel payment. It will be observed by reference to the claim of the said Macomber that the Superior Court Judge (pp. 96-103) undertook to make Findings of Fact, Conclusions of Law, and a Decree. No process of any kind was issued other than that contained in the order of March 23, 1918, which is as follows: "Ordered that a copy of the foregoing order and a copy of the Petition upon which it is based be served upon said subscribers personally and also upon R. D.

Simpson as Trustee of Peter Thompson, Bankrupt; or if they cannot be found in King County, Washington, that a copy of said order be mailed by registered mail to the subscribers and to the said R. D. Simpson as trustee of Peter Thompson, Bankrupt, to their last known addresses as specified in the Petition".

In the absence of the trustee the order, making call and assessment, etc. (pp. 137-143), was presented to the Superior Court Judge. It will be noted that the court recites, "R. D. Simpson as Trustee of Peter Thompson *Company*, Bankrupt, appearing in the action as appears by the files and records herein but not appearing at this hearing". Of course R. D. Simpson at no time has ever been trustee of Peter Thompson *Company*, the latter being a corporation and in the hands of L. H. Macomber as receiver. The certified copy of the case of *Alex. Kobrinetz et al. vs. Peter Thompson Company*, of the Superior Court of King County, Washington, discloses a proposed stipulation signed by R. D. Simpson as trustee looking to an extension of time for hearing on the order of March 23, 1918, referred to above. In this connection reference is made to the affidavit of W. W. Keyes (pp. 151-152), from which it appears that he prepared a stipulation looking to an extension of time for hearing upon the "Order Making Assessment", and forwarded it to the attorney for the receiver. The latter, however, being unwilling to consent to such a continuance refused to sign the stipulation, and,

instead of returning it, filed the same with the Superior Court of King County. This was done without the knowledge of the said R. D. Simpson or his attorney. Based upon this unwarranted act of the attorney for the said Macomber the Superior Court of King County inserted in its findings, "R. D. Simpson as Trustee of Peter Thompson Company, Bankrupt, appearing in the action as appears in the files and records but not appearing at this hearing".

We submit that it is fundamental and needs no citation of authority that a binding and conclusive judgment cannot be entered against a person except under statutory process. In the State of Washington it is based upon a Summons and Complaint. *Service* may be waived by appearance, but in order to get the person under the jurisdiction of the court so that a final judgment may be entered it is necessary to issue the legal process provided by the statute, which in the State of Washington is the Summons, so that if it may be considered for the argument's sake that R. D. Simpson as Trustee of Peter Thompson, Individual, voluntarily appeared at the hearing before the Superior Judge in King County, he could not be bound to any greater extent than that contemplated in the Petition and Order of March 23, 1918, which was simply appointing a time for hearing petition "*for call and assssement*". Any order made by the Superior Judge other than directing the receiver to demand payment, and in the event of refusal to institute

suit against those apparently liable on their stock subscription, would be absolutely void. However, no appearance was made by the Trustee in this proceeding, and it seems shocking that a contention is made that a binding and conclusive judgment can be entered as to him by simply writing him a letter that a hearing will be had in a certain court on a petition for "call and assessment" against certain stockholders, one of which happens to be in bankruptcy.

> "No conclusive effect can be given to a judgment which is absolutely void, whether its invalidity results from a want of jurisdiction over the parties or over the subject matter of the controversy, or from a want of authority in the court to go beyond the pleadings and evidence and render a judgment on a matter not in issue or submitted to it. There are also authorities holding that a judgment obtained by fraud is so far invalid that it is not of conclusive force as an estoppel."
>
> (23 Cyc., 1235-1236).

A long list of cases is cited in support of the text just quoted, including Alabama, Ark., Calif., Ga., Mich., Montana, N. J., N. Y., Utah, Colorado, Indiana, Iowa, Maine, Nebraska, N. C., Tenn., Texas, U. S., and England. We respectfully challenge opposing counsel, and now ask him to point out authority for the Superior Court of King County to enter and make Findings of Fact, Conclusions of Law, and a Decree, upon the record which shows, as we have stated, merely a Show Cause Order mailed to the stockholders notifying them

that a hearing would be had for "call and assessment" upon their alleged stock subscriptions. The statutes of all States specify a given time within which a defendant has to appear before judgment can be rendered against him, and in the State of Washington the period is twenty days if service is made upon defendant within the State. The notice signed by the Superior Court Judge on the 23d of March, 1918, fixes the date for hearing thereon on the 29th day of March, 1918. But why pursue the argument further? May courts shorten the time within which parties are entitled under the law to appear, even conceding that in the instant case the parties were notified that a judgment would be rendered unless they did appear—no such notice having been given, however? Not only was the notice sent to the stockholders, in so far as being a basis for a judgment insufficient, but also the service of the same was insufficient, and likewise the time within which the law gave them for appearance. To say that a judgment procured by writing one of the parties a letter is binding and conclusive upon a court of concurrent jurisdiction is monstrous in the extreme.

Again referring to the order of March 23, 1918, it will be observed that this was made in conformity with the established practice of the State of Washington. In *Chamberlain vs. Piercy*, 82 Wash. 161, the Supreme Court of Washington announces the correct rule in the following language: "The rule in this State, as evidenced by the de-

cisions of this Court, is that where a receiver is appointed for an insolvent corporation, before he can maintain an action against a stockholder it is necessary that such stockholder have notice and an opportunity to be heard upon the *validity of the claims or alleged debts of the insolvent company,* and *that an order be entered directing proceedings against the stockholders whose* subscriptions are unpaid for such amount as, together with the assets, will be sufficient to meet the liabilities and costs of the receivership", citing *Grady vs. Graham,* 64 Wash. 436; 116 Pac. 1098; 36 L. R. A. (N. S.) 177; *Beddow vs. Huston,* 65 Wash. 585; 118 Pac. 752.

A stockholder is not called upon to plead or assert his defenses until suit has been instituted against him, and under the decisions of the Supreme Court of the State of Washington, as will have been noted from the quotation above, the suit cannot be instituted until application has been made to the court in which the receivership proceedings is pending, of which application the stockholder must be given notice in order to have an "opportunity to be heard upon the validity of the claims or alleged debts of the insolvent company". It is quite manifest that this is all that was contemplated under the order of March 23, 1918, to which reference has been made so many times. In the receivership proceedings, that is, in the case of *Kobrinetz et al. vs. Peter Thompson Company,* a judgment was undoubtedly entered, or should have been entered, against the defendant, and on top of

this we have the anomalous situation of another judgment entered in the same proceeding against another party entirely foreign to it.

Whether it would be incumbent upon the receiver in the State Court proceedings to institute an action against the Trustee in Bankruptcy in a proper tribunal is not now a question before the Court. We insist, however, that the Trustee in Bankruptcy of one of the individual stockholders of the insolvent corporation could not have any lesser rights than the individual himself would have had had there been no bankruptcy proceedings. There must be some tribunal where the defenses that a stockholder has, or his successor in interest—Trustee in Bankruptcy in this case—can be asserted. In the instant case we have not questioned the jurisdiction of the Referee in Bankruptcy to pass upon the validity of the claim of the receiver, assuming that it is entitled to be filed at all.

II.

The second objection (Assignment of Error p. 144) urged by the Trustee to the claim of the receiver sets up that the bankrupt had fully paid for every dollar's worth of stock subscribed for by him; that is, that he had been conducting a certain business in the City of Seattle, Washington, in his individual capacity and which he subsequently incorporated, and in so doing turned over to the corporation this individual business in payment for his stock subscription. This involved a question of

fact and would necessitate the taking of testimony. However, the District Judge, under the theory that the King County Judgment entered in the receivership proceedings was binding and conclusive, on motion of the Receiver (pp. 126-127), struck this Objection (pp. 130--31). At no time or place has Peter Thompson or his Trustee been called upon to prove the allegations of fact above set forth. In the preliminary hearing in the receivership proceedings in King County one question only could be considered by that court, namely, the validity of the claims or alleged debts of the insolvent company. (*Chamberlain vs. Piercy, supra*). The reasons advanced in the preceding discussion apply here, and we will not pursue the matter further.

III.

Assignment of Error (c), (p. 144), discloses the third Objection of the Trustee, in brief being that the Peter Thompson Company on the 24th of February, 1917, turned over its business to the Seattle Merchants' Association, the latter organization operating the said business for a time, finally disposing of it and distributing the proceeds to the creditors of the corporation; further setting up that the amount so realized and distributed was sufficient to pay the creditors of the corporation in full and did actually pay them in full, and that all debts contracted by the corporation after the date of its organization, namely, October 5, 1916, had been paid in full, and that the alleged indebtedness represented by the Receiver, Macomber, was con-

tracted by Peter Thompson prior to the organization of the Peter Thompson Company and hence there could be no liability growing out of his stock subscription by reason of said indebtedness. We submit that if the facts as alleged in the Objection are true, the samed constitutes a complete defense to the receiver's claim. At all events, the Trustee should have an opportunity in some tribunal to offer evidence to support the allegation.

The only theory known in law that we are aware of under which a stockholder is held liable for his unpaid subscription is that the capital stock is a trust fund for creditors. That is to say, that where a corporation holds itself out as having a certain capitalization it will be presumed that creditors relied on the representations thus made and extended credit on the faith that the corporation had the given capitalization; and in the event it should develop, when the corporation becomes insolvent, that all of the capital stock had not been paid for, courts of equity will compel those subscribers to pay in the unpaid portion sufficient in amount to take care of the corporate indebtedness, with the limitation, of course, that no subscriber will be held beyond the balance actually due on his subscription. If the indebtedness represented by the Receiver, Macomber, has not been created through an extension of credit to the corporation, but on the contrary through an extension of credit to Peter Thompson as an individual prior to the date of the incorporation of the Peter Thompson

Company, namely, October 5, 1916, then clearly the receiver of the corporation could not set up such indebtedness as a claim against Thompson's alleged unpaid subscription to the stock of the corporation. What has actually happened in the given case—and indeed the Superior Court of King County practically finds as much—is that the corporate assets have been exhausted and enough was realized from that source, and more, to pay the corporate debts in full, and that the only debts not paid are those contracted by Peter Thompson in connection with the Seattle store prior to incorporation. We assert that these facts can be proven and that the Trustee should have an opportunity to prove the same. It may be urged that the corporation assumed the existing indebtedness of Peter Thompson, the individual, so far as the Seattle store was concerned, and without denying this, we are at a loss to see how the Receiver can collect under the guise of liability on an unpaid stock subscription to liquidate a debt that was created prior to the existence of the corporation. Again, it may be urged that these creditors represented by the Receiver at all events have a claim directly, that is, through themselves, against the bankrupt estate. This is a question, however, not now before the Court, and as a matter of fact such claims have been presented and disallowed. Good and complete defenses have at all times been available to the Trustee against the claims of these creditors when presented direct instead of being presented through the shibboleth of an unpaid stock subscription.

IV.

Assignment of Error (d), (p. 145), covers the fourth Objection to the claim in question. Briefly it is that Peter Thompson transferred to the corporation his entire business, including good-will, without a compliance of the Sales in Bulk act of the State of Washington; that at the time of such transfer said Peter Thompson had numerous creditors, including those who are represented by the Trustee herein, and who had sold Thompson merchandise for his Tacoma store, and that any transfer of a stock of merchandise in bulk without a compliance of the Sales in Bulk act of Washington would be null and void as to those creditors not participating in the proceeds from the sale of the merchandise so transferred, and that the creditors represented by the Receiver, Macomber, were the sole beneficiaries of the proceeds from the sale of the said merchandise, and that having appropriated the proceeds to themselves to the exclusion of the other creditors of Thompson, namely, those represented by the Trustee herein, are now estopped to claim against the funds realized from the sale of assets of the Tacoma store. Section 5297 of Remington's Code is as follows:

> "Whenever any person shall bargain for or purchase any stock of goods, wares, or merchandise in bulk for cash or on credit and shall pay any part of the purchase price or execute or deliver to the vendor thereof or to his order or to any person for his use, any promissory note or other evidence of indebted-

> ness for said purchase price or any part thereof without first having demanded and received from said vendor or from his agent the statement provided for in Section 5296 and verified as there provided, and without paying or seeing to it that the purchase money of the said property is applied to the payment of the bona fide claim of the creditors of the vendor as shown upon such verfied statement, share and share alike, such sale or transfer shall be fraudulent and void."

Section 5296 sets forth that the vendor must execute a complete list of his creditors and verify under oath that the same is correct, etc.

Under the decisions of the Supreme Court of Washington, where there is a non-compliance with the Bulk Sales law, it is in legal effect the same as if there had been no transfer whatsoever, and the title to the goods remains in the vendor, and the vendee merely holds the same in trust for creditors. The Seattle Merchants' Association, under its assignment of the 24th of February, 1917, acquired no greater or lesser rights than its assignor, Peter Thompson Company, and whatever obligations might have attached to the assignor these same obligations are binding upon the assignee and must be fulfilled. As is often said, the assignee merely steps into the shoes of his assignor. The receiver appointed more than a year afterwards would acquire no greater rights than the corporation itself had, he being substituted for the assignee, and it follows, therefore, that neither the assignee nor the receiver ever acquired any title to the merchan-

dise transferred or the proceeds therefrom other than that of a trustee title, and that neither the Company nor its successors in interest has fulfilled its obligations to Thompson's creditors existing at the time of the transfer. We quote from *Friedman vs. Branner*, 72 Wash. 338.

> "The statute and its interpretation as found in our previous holdings answers each of these questions in the affirmative. The statute is found in Rem. & Bal. Code 5296 *et seq.* It provides that, in cases of all transfers of merchandise in bulk, or whenever substantially the entire business or an interest therein is disposed of, an affidavit shall be required, showing the names of all creditors, with the indebtedness due or to become due, and that when such affidavit is not taken, or the purchaser shall not see to it that the purchase price is applied to the payment of claims of creditors of the vendors, such sale or transfer 'shall be fraudulent and void.' There can be no question but that under these provisions the sale to Sullivan was void as against the creditors of Branner. The sale being void, the property was the property of Branner in contemplation of law; or, if it or any part of it had been disposed of, the money obtained from its sale was the money of Branner. It is immaterial to what extent the original property obtained from Branner remained in the possession of Sullivan at the time of the garnishment. Unthis statute, *Sullivan had either the property itself or its purchase price.* It was immaterial which; *either was the property of Branner* and subjected Sullivan to garnishment as having money or property of Branner in his posession or under his control.

'In *FitzHenry v. Munter*, 33 Wash. 629; 74 Pac. 1003, and *Kohn v. Fishback*, 36 Wash. 69; 78 Pac. 199; 104 Am. St. 941, we held that, when the statutory affidavit was not taken, the goods attempted to be disposed of by the sale remained the goods of the vendor, and as such in the hands of the vendee were to be regarded as a trust fund, and the vendee the trustee for the benefit of the creditors of the vendor. As in legal contemplation the sale to Sullivan was fraudulent, the possession resulting from the sale was wrongful. Sullivan's position is in law no better than that of a purchaser of property for the purpose of defeating the just claims of his vendor's creditors. He can retain neither the property, nor, in case of its sale, the money obtained therefrom. *Millar & Co. v. Plass*, 11 Wash. 237, 39 Pac. 956; *Cowles v. Coe*, 21 Conn. 220. And, since he was wrongfully in possession of the property or its equivalent, Sullivan stands as does any other person who has wrongfully converted property to his use. He cannot say the remedy of those entitled to the property is against the property itself only, but must respond in damages for its conversion. It is, we think, well established that, when a trustee such as Sullivan was in legal contemplation, in violation of his trust disposes of the trust property, he is personally liable."

From the above quotation it is apparent that the sale of the property by Thompson to the corporation was void as against his creditors, and that in contemplation of the law the property in possession of the corporation and subsequently in possession of the Seattle Merchants' Association as trustee, was the property of Thompson, and that the goods attempted to be disposed of by the sale remained

the goods of Thompson and as such must be held by the corporation or its successor in interest as trustee for all the creditors of Thompson. Such being true, what can be said of those creditors, now represented by the receiver, who have wilfully participated and appropriated to their own use the proceeds of the corporate property which, in truth and fact, was the property of Thompson individually and subject to the satisfaction of the claims of all of his creditors regardless of the place of their location? It is a maxim of equity that "he who comes into equity must come with clean hands", and another maxim, that "he who asks equity must do equity". It appears from the Objection that these creditors of the Seattle store have not only appropriated to themselves the entire assets of the Seattle business in defiance of the legal rights of crditors of the Tacoma store, but in addition thereto, after such an appropriation, are brazenly asserting their claims for their pro rata share of the money realized from the sale of the Tacoma store. These creditors have participated in a fraudulent and notorious violation of the rights of the creditors of the Tacoma store. It is apparent, we think, that their conduct has barred them from any consideration at the hands of this Court, and their claims are only entitled to consideration when they pay to the trustee herein the dividends which they have received, so that the entire estate may be pro-rated among all creditors of the bankrupt. And this course of conduct they have not chosen to follow. The very commonplace quotation is applicable, they

are endeavoring "to keep the nickel and the candy both".

Nominally these creditors are endeavoring to collect a stock subscription; actually they are endeavoring to collect debts contracted before a corporation was in existence, and having appropriated the entire estate of the Seattle store, in definance of the rights of creditors of the Tacoma store, should not be heard.

We submit that there is a full and complete estoppel as to these creditors represented by the receiver.

V.

Assignment of Error (e) (p. 146) asserts that the claim of said Macomber as receiver is based upon a contingency and was not an existing debt at the time of adjudication of the bankrupt, and hence not a provable claim. If our contention is sustained in this regard it will be unnecessary for the Court to consider the other Assignments of Error, because this will dispose of the entire claim. Section 63 a-b of the Bankruptcy Act as amended sets forth what debts may be proved. Peter Thompson was adjudged a bankrupt in April, 1917. A receiver was appointed for the Peter Thompson Company in March, 1918, or about eleven months thereafter. As has been already pointed out, the receiver of the corporation asserted that Peter Thompson had not fully paid for the stock subscribed for by him in the corporation in that the property turned over by

Thompson in payment of his stock subscription was not worth what Thompson and the corporation agreed between themselves it was worth, and upon that theory secured from the Superior Court of King County, Findings and Decree to the effect that Thompson had not paid for his subscription in full. At the threshold it will be noted that the alleged liability of Thompson is not based on a subscription contract payable in cash or in certain installments or subject to call; but on the contrary is based on the supposition that Thompson turned over property of insufficient value, and hence the corporation and himself perpetrated an implied fraud upon the creditors of the corporation.

Section 63 of the Bankruptcy Act sets forth certain debts which may be proved, and the parts thereof which are pertinent to the inquiry here are "founded on an open account or upon an account expressed or implied; and founded upon provable debts reduced to judgments after filing of the petition", etc. There is no provision in the section for the proving of contingent liabilities, and the difference between this Act and the Act of 1867 is noteworthy, the latter providing as follows:

> "In all cases of contingent debts and contingent liabilities contracted by the bankrupt, and not herein otherwise provided for, the creditor may make claim therefor, and have his claim allowed, with the right to share in the dividends, if the contingency happens before the order for the final dividends; or he may, at any time, apply to the court to have the present value of the debt or liability ascer-

> tained and liquidated, which shall then be done in such manner as the court shall order, and he shall be allowed to prove for the amount so ascertained." (Collier, p. 977—Note 230 Bankr. Act. 1867, Art. 19, R. S. Art. 5068).

As between the creditors of the corporation and Thompson, his liability is dependent upon two things, namely: First, whether or not the corporation has sufficient assets to pay its creditors in full. If there were sufficient assets the creditors, or the receiver as their representative, could have no just cause to complain against a stockholder who had not paid his subscription in full. Secondly, certain steps have been laid down by the Supreme Court of Washington as a prerequisite for fixing liability when the assets of a corporation are insufficient. *Grady vs. Graham*, 64 Wash. 436; *Beddow vs. Huston*, 65 Wash. 585. It is clear that there are two contingencies, namely: (a), where the *existence* of an alleged claim depends upon a contingency; and (b), where the *right to assert* a claim depends upon a contingency. The Bankruptcy Act has never recognized the provability of claims where the former situation exists, either under the old Acts or under the Act of 1898. Under the head of Contingent Liabilities (Collier, 11th Ed. *et seq.*), Mr. Collier says:

> "There is a broad distinction between 'unliquidated damages' and 'contingent liabilities'. The phrase 'unliquidated claims' may refer to both. The former law provided for the liquidation of contingent debts and liabilities, and the cases under it, as well as those

> under its predecessors, drew a clear distinction between demands whose existence depended on a contingency and existing demands where the cause of action depended on a contingency; the former not being provable in any event and the latter only when liquidated. The present law has no similar clause and it has been vigorously asserted that contingent claims cannot now be liquidated or proven."

In connection with the above we respectfully direct the Court's attention to the note contributed by Mr. James W. Eaton, former editor of Collier's, appearing on page 978, Collier's 11th Edition.

The contention which the Trustee makes in the instant case is that the claim of the receiver, Macomber, is not a provable claim even under the old Act, to say nothing of its status when considered in the light of the new Act. The District Judge refers to several cases in his opinion, the first being

In re Rouse, 1st Am. B. R. 393.

It is interesting to note that Mr. Remington (this opinion was written by Mr. Remington as Referee in Bankruptcy and apparently was not reviewed by the District Court), discusses whether or not the claim was provable under the Bankruptcy Act of 1867; and, second, he states on page 408:

> "We must bear in mind that this objection is introduced at first meeting of creditors, when we are receiving proofs of debt for the purpose of selecting a trustee, and not at a subsequent meeting of creditors, nor for the

allowance of claims for a dividend. In proving debts for the purpose of choosing a trustee, it seems from a consideration of the clauses of the act *in pari materia*, we are not expected to be extremely accurate.

"The proof accepted by the Referee at the first meeting is by no means final. The claims are subject to modification, diminution, or rejection."

It is interesting to note, however, that in the particular case he did not allow the claim even for voting purposes, not on the ground, however, that it was not a provable debt. He considers the claim in connection with the statutes of Ohio. The particular statute applicable is not quoted, but apparently is very much like the old statutes in various states, which make stockholders personally liable for the debts of the corporation regardless of whether or not they have paid their subscriptions in full. Mr. Remington says, "It is a collateral security for the benefit of creditors * * * a contract of suretyship for corporate debts". In other words, under the Ohio statute, the liability of a stockholder was the same as the liability of a surety on a note, that is, an *absolute liability*, and finally the author, by way of conclusion, lays down this rule, "Therefore I would say that in Ohio the individual liability of stockholders for debts of an insolvent corporation is a provable debt in bankruptcy whenever the circumstances are such that a stockholder's suit would lie". As pointed out, this conclusion was reached at the first meeting of creditors. The

author assumed that under the Ohio statutes the liability was fixed and the debt actually existing *at the time the stockholder filed his petition in bankruptcy.* In the instant case, of course, the bankruptcy preceded the receivership nearly a year and there was no liability until it had been determined whether or not there was sufficient corporate assets to pay the corporate debts, and not even then until there had been a further determination by some competent tribunal that the property turned over by Thompson was insufficient to pay his subscription.

Dight vs. Chapman, 12 Am. B. R. 743; 65 L. R. A. 785, not cited by the District Court, is a case shedding some light on the matter under discussion. The facts in this case are these:

In September, 1890, the Duluth Dry Goods Company was incorporated in Minnesota and issued 1309 shares of stock of the par value of $100.00 each, fifty shares of which defendant Chapman subscribed for. Under the constitution and laws of Minnesota a stockholder is liable for the debts of the corporation to the extent of the par value of the stock held, which obligation is enforcible by a receiver appointed for that purpose. In February, 1899, a decree was entered establishing the indebtedness of the corporation and awarding recovery against it and against the stockholders severally for sums equal to the par value of the stock owned by each, and in pursuance of that decree Dight was appointed receiver to make the col-

lection from the stockholders. In January, 1900, Chapman filed a petition in bankruptcy, and in filing his schedules he did not include his liability on his stock subscription, although it appeared that he had full knowledge of the proceedings in Minnesota. The question arose therefore as to whether or not Chapman was released of his obligation of the Minnesota judgment by his discharge in bankruptcy. The Court says:

> "It will be remembered that the defendant did not appear in the original suit, but as a decree in that case was rendered, *prior to his being adjudged a bankrupt*, whereby all the stockholders were required severally to pay a sum of money equal to the par value of their stock, such decree resolved the uncertainty, imposed the contractual liability and, in our opinion, rendered the sum so awarded a 'provable' debt within the meaning of the bankruptcy act. (*Riggins vs. Magwire*, 15 Wall. 549; 21 L. Ed. 232; *Re Fife*, 109 Fed. 880)."

But one inference can be drawn from this case, namely: had not the stockholders' suit been prior to the bankruptcy, and thus "resolved the uncertainty", and "imposed the contractual liability", the claim would not have been provable.

In the case of *In re Walker*, 21 Am. B. R. 132, also not cited by the District Court, the question arose as to the construction to be placed upon the banking statutes of California. The constitution of that State as well as the statute makes stockholders of a bankrupt corporation liable for his proportion of the debts of the corporation during

the time he was such stockholder, which liability, according to the previous decisions of the California court, arises at the time when deposits are made. We have a somewhat similar statute in the State of Washington, except that a stockholder's liability is double the amount of his subscription to the stock. The Supreme Court of California has also held that the statute was a part of the contract made by the stockholder and hence created an absolute liability. The question in the particular case under discussion arose on a demurrer to the sufficiency of the petition. The opinion announces nothing not in harmony with the contention we make in the case at bar.

The case of *Van Tuyl vs. Schwab et al.*, 38 Am. B. R. 161, cited by the District Judge, raised a very similar question to that in *In re Walker*, *supra*. The New York court was called upon to interpret the banking statutes of that State, and in that connection says:

> "It is, of course, well established that a debt, in order that it may be discharged in bankruptcy, must not only answer the above description (referring to Sec. 63 of the Bankruptcy Act), *but must also be provable at the date on which the petition in bankruptcy is filed.*"

The Court then quotes a section of the bankruptcy law under which the stockholders are being charged, and concludes that under the previous decisions of New York a subscriber in a *bank* incorporates into his contract the statute in question and

that therefore such subscriber is *absolutely* liable at all times. The Act says:

> "If default shall be made in the payment of any debt or liability contracted by any such corporation, the stockholders thereof shall be individually responsible equally and ratably."

Says the Court also in referring to *Corning vs. McCullough*, 1 N. Y. 55:

> "The words affixing liability to the stockholders under that case are precisely equivalent to the words used in the banking law above quoted. *The liability is made absolute.*"

It is interesting to note also in connection with the case under discussion that the Superintendent of Banks under the State of New York took possession of the bank in question, the Carnegie Trust Company, on January 1, 1911, and that an involuntary petition in bankruptcy was filed against the respondent on April 12, 1911, and he was adjudicated in November, 1912. In other words, the statutory receiver took charge of the bank prior to the bankruptcy of the individual stockholder, and even if the statute had not made the liability of the stockholder an absolute one, it became fixed and determined, that is, it was an existing debt at the time of the filing of the petition in bankruptcy by the stockholder.

The Court was very careful to say in the *Van Tuyl* case that the debt, in order to be a proper claim against the bankrupt estate, "*must be provable at the date on which the petition in bankruptcy is filed.*"

Where property is turned over to a corporation at a fixed value in payment of a subscription to the capital stock the contract is absolutely binding between the parties, and only where it appears that the property so turned over was of such insufficient valuation as to amount to a fraud on creditors can the transaction be attacked, and only then, of course, when the corporation becomes insolvent and has not sufficient assets with which to liquidate its indebtedness. No one disputes this ruling. It is the application of it to the instant case that has given rise to differences of opinion. The District Judge refers to the Washington statute quoting, "Each and every stockholder shall be personally liable to the creditors of the company to the amount of what remains unpaid upon his subscription to the capital stock and not otherwise". However, what follows, which is not quoted, "Provided that the stockholders of every bank incorporated under this Act or the Territory of Washington shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts and engagements of such association accruing while they remain such stockholders, to the extent of the amount of their stock therein at the par value thereof, in addition to the amount invested in such shares". (Rem.'s Code, Sec. 3698). It is very evident that the object of the statute is to limit the liability of stockholders of private corporations in distinction to banking corporations so that they could never be called upon to respond to any greater extent than the unpaid portion of their

subscription. The statute, in our judgment, adds nothing to the contract made by a stockholder. He has always been liable, even at common law, to carry out his contract of subscription, and the purpose of the statute is, as we see it, simply to *limit* and define his liability.

Thompson's liability, conceding for the argument that he is liable at all, could not and did not arise or come into being until many months after he was adjudicated a bankrupt. It requires, we think, quite a stretch of the imagination to say that at the time Thompson was adjudicated a bankrupt, or at the time of the filing of his petition, the claim in question was an *existing* debt. Assuming that Thompson turned over property of insufficient valuation, it is clear that he might or might not be called upon to pay the difference between what he did pay and what he obligated himself to pay. If, perchance, the corporation had been successful or had accumulated sufficient assets from another source so as to pay its creditors in full Thompson could never have been called upon and would never have been liable, and the conditions under which the liability arose in the present case necessarily created the liability many months after the bankruptcy proceeding.

The District Judge has also cited, without comment, the case of *Irons vs. The Bank*, 27 Fed. 591. The opinion in this case is a review of a previous decision of the court made by the same Judge and reported in 17 Fed. 308. We think that this case

very much sustains our position. A reference to the same in the 17 Fed., particularly to page 314 thereof, discloses that the court is discussing the Bankruptcy Act of 1867, heretofore quoted, and which was repealed by the Amendment of 1898. The question before the court was on the liability of stockholders in a National bank, and involved the interpretation of the National Banking Act, which was similar to the New York Banking Act, referred to in the *Van Tuyl* case.

Judge Blodgett in 27 Fed. says:

> "I think the fallacy of much of the argument in this case results from the examination that the provisions of the Banking law in regard to the enforcement of the individual liability of the stockholders for the payment of debts is to be construed and governed by the rules in regard to the statutory liability of the stockholders in State corporations."

In brief, the opinion is based on the supposition that under the National Banking Act the subscriber's obligation is absolute and not contingent. However, it is not necessary to even decide this question, in view of the Bankruptcy Act of 1867.

It is also interesting to note, in passing, that an action had been begun to enforce stockholders' liability in February, 1875, and a receiver was appointed a few days thereafter. In 1876 an amended bill was filed and the defendants were all adjudged bankrupt after the filing of the amended bill. We have then before us the provisions of the old Bankruptcy Act of 1867, the further specific provisions

of the National Banking Act, coupled with the further fact that steps had been taken to enforce the absolute liability of the stockholders prior to the time that said stockholders went into bankruptcy. The District Judge has also cited the case of *Cary vs. Mayer*, 79 Fed. 926. This case is not unlike those previously discussed, and an examination of the same shows it is not in conflict with the position taken by the trustee. Mayer, prior to 1866, was the holder and owner of 450 shares of the capital stock of a Virginia corporation of the par value of $100.00 per share. When he acquired this stock there had been paid on account of the same $20.00 per share. The law of Virginia required that $2.00 per share should be paid at the time subscription was made, and that the residue should be paid as required by the president and directors.

In September, 1866, the corporation made a trust deed of all of its property to three trustees, who continued to operate and manage the business. Nothing was done by the trustees or the officers of the corporation looking to a call upon the balance of the subscription contract, and in 1871 a creditors' suit was commenced, the object of which was to compel a call of the unpaid subscriptions sufficient to pay the debts of the company. Nothing was done on this suit until 1880, a little more than nine years afterward, when a decree was entered making a call of thirty per cent on the various stockholders. In 1868 Mayer applied to the District Court of New York to be declared a bankrupt.

Subsequently, in 1879, he was discharged by the court from all debts and claims which were provable against his estate on March 29, 1868.

The question in the case was whether Mayer was discharged from his stock liability, the amount of which was fixed and determined by the decree in 1880. At the threshold, the question of laches on the part of the corporation and its successors appears to be a very persuasive feature in the case. The Court properly held that Mayer had been discharged and in that connection discussed the old Bankruptcy Act. It will be noted also that in this case there was an express contract to pay a given amount of money. The time when the payment was to be made was left by the terms of the contract to the president and board of directors, or their successors. Manifestly the debt was an absolute liability at the time Mayer went into bankruptcy. His contract was the equivalent of a promissory note.

In speaking of the Act of 1867, the Court says:

> "Section 5068 (Revised Statutes) provided that the creditor could make claim for a contingent debt or a contingent liability and have his claim allowed with the right to share in the dividends if the contingency happened before the order for the final dividend. A contingent debt or liability is not provable when the time for its becoming a debt is uncertain and not ascertainable, or the amount is uncertain and not to be ascertained", citing *Riggins vs. Magwire*, 15 Wall, 549; *Wolf vs. Stix*, 99 U. S. 1.

In speaking of the duties of the trustees relative to their obligations to have the call made either by the corporation or a proper court, the opinion further stated:

> "This intervention it was the duty of the trustees to obtain. They could not properly lie still, and permit these assets to disappear by the death or the insolvency of the stockholders; and we can now see that, if they had set proceedings in motion before a Virginia court in 1866, an assessment would have been made within a reasonable time. There was no practical difficulty, under the facts disclosed in the record, which should have prevented the trustees from presenting their claim against the bankrupt estate, and if the assessment should be made by the court of chancery before the final dividend, of having the claim allowed in the amount which that court should have ascertained".

Applying this case to the one at bar, it is evident that if the Act of 1867 was still the law and Peter Thompson had paid only $20.00 on account of his subscription, and it had been provided that he should pay the balance in money when called upon by the trustees of the corporation, then the *Mayer* case would be in point. When we remember, however, that Thompson claims to have paid his subscription in full, and he certainly has so far as relations between himself and the corporation are concerned, and remember further that the basis of the alleged liability of Thompson is his fraudulent act in turning over property of insufficient valuation, which would require the solemn decree of a

proper tribunal to create the debt, we can appreciate the distinction between the two cases.

It is interesting to note also that in the case under discussion the Court comments on the old English case of *The Railway Co. vs. Burnside*, 5 Exch. 129, and quotes therefrom as follows.

> "The contract on which the shareholder's obligation is founded is not to pay a certain fixed sum upon a future contingency, but such sum or sums as may be required from himself and all the other shareholders from time to time not exceeding a certain sum and regulated by the wants of the Company. At the time of the bankruptcy it was uncertain what the sum would be which the defendant would be called on to pay, and no certain debt was then contracted".

The New York Circuit Court took the position that this English case was not in point, although it is interesting to note that it is cited as an authority for the position taken by the Supreme Court of the United States in *Garrett vs. American File Co.*, 110 U. S. 288, which we will refer to later on.

In *Riggins vs. Magwire*, cited above, the Supreme Court of the United States establishes this rule, "Where the claim is founded upon a contingency contained in a contract which may never arise *and there is no means of ascertaining the amount of the claim at the time of the filing of the petition*, the claim is not provable". This disposes of the cases cited by the District Court.

The rule for which we contend is stated in 7 R. C. L., par. 397,

> "Calls made and remaining unpaid prior to the bankruptcy of a stockholder, undoubtedly are covered by his discharge in bankruptcy; but such discharge is no bar to an action for an instalment subsequently called for, *the unpaid and uncalled subscription not constituting such a debt or liability as is provable against his estate in bankruptcy.* It seems that a discharge in bankruptcy releases a shareholder from his statutory liability to creditors of the corporation, where, at the time of his discharge, the claims of the creditors were provable and not merely contingent.
>
> "Also where the assignees in bankruptcy of a stockholder never accepted the stock and never consented to become stockholders in the company, neither they nor the assets of the bankrupt in their hands are subject to the individual liability of stockholders for the debts of the corporation."

See also 5 Cyc. 324, to the effect:

> "There is no provision in the present act making a contingent liability provable in bankruptcy."

In re Mullins Clo. Co., 38 Am. B. R. 189, quoting from page 199, we find,

> "The Bankruptcy Act of 1841 and that of 1867 provided for the allowance of contingent claims. The present Act, however, makes no provision for the proving of such claims, and it is well understood that they are not provable".

In discussing section 63-b of the Act of 1898, with reference to unliquidated claims, the Court, after quoting same, says:

> "This, however, relates merely to the procedure and does not define an additional class of debts which are provable", citing
>
> *Dunbar vs. Dunbar*, 190 U. S. 340-350; 10 Am. B. R. 139.

Also in

Zevela vs. Reeves, 227 U. S. 677,

the Supreme Court holds emphatically that in relation to debts founded upon open accounts or upon a contract, express or implied, which may be provable under the Bankrupt Act of 1898, there is included only such as existed at the time of filing of the petition in bankruptcy.

We respectfully submit that the receiver's claim must be disallowed for the reason it was not in existence at the time Thompson filed his petition in bankruptcy. The validity of any claim against him depended upon two contingencies:

1. That he and the corporation had committed fraud in accepting the property in full payment of his stock subscription.

2. That there had been a preliminary hearing as outlined in *Chamberlain vs. Piercy, supra.*

Neither of these things was done until after Thompson filed his petition in bankruptcy.

VI.

The sixth and final Assignment of Error (f) (pp. 146-147) presents the question of the right of the trustee to reject the stock of the corporation as a burdensome asset, and by thus rejecting it relieve himself and the estate which he represents from any liability growing out of it. 4 Thompson on Corporations, 2d Edition, par. 4897, states the rule as follows:

> "It seems that no court has held that the assignees of insolvent estates, part of whose assets consist of corporate stock, are subject to the statutory liability imposed upon stockholders. And the fact that an assignee attended the corporate meetings and acted as a stockholder was held insufficient to make him liable. The same principle has been applied in cases arising under the Bankruptcy law on the theory that an assignee is not bound to accept property of an onerous or unprofitable character".

Again, in 5 Thompson on Corporations, 2 Ed., in the latter portion of par. 5192, where a long list of cases is cited, we find,

> "A discharge in bankruptcy of the stockholder will not release the stockholder unless he has turned over the shares to the assignee and he has accepted them. The rules do not require the assignee in bankruptcy to accept onerous property of the bankrupt".

The case of the *American File Co., vs. Garrett*, 110 U.S.288,28 *Law Ed.*, 150, the Supreme Court of

the United States seems to have definitely settled this question in favor of our contention:

"It is well settled that, under the circumstances of the case, neither the assignees nor the assets in their hands are subject to the individual liability which attaches to stocks held by the bankrupt. The evidence does not show that the assignees acted in any way as stockholders, that they ever attended meetings of the corporation, or that their names appeared upon the books, or that they treated the stock standing in Chapman's name as an asset of his estate. They merely had in their possession the certificates of stock and yielded to Garrett & Sons any claim to the bonds of the American File Company belonging to Chapman or his firm, and took an indemnity against any supposed liability which might attach to them as holders of the stock belonging to the estate of Chapman.

"In *Gray v. Coffin*, 9 *Cush.* 192, the Supreme Court of Massachusetts, having under consideration a law of that State almost identical with the Rhode Island statutes, held that the individual liability of 'stockholders did not attach when their assignee had attended and voted at meetings of the corporation and done other acts of unequivocal ownership.' The same result would follow under the bankruptcy law. It has long been a recognized principle of the bankruptcy laws that the assignees were not bound to accept property of an onerous or unprofitable character. *South Staffordshire R. Co. v. Burnside*, 5 Exch. 129; *Furdoonjee's Case*, 3 L. R. Ch. Div. 268; *Ex. parte Davis*, 3 L. R., *Ch. Div.*, 463; *Streeter v. Sumner*, 31 N. H. 542; *Amory v. Lawrence*, 3 Cliff. 523; *Rugely v. Robinson*, 19 Ala. 404. As the assignees of Chapman never accepted

the stock, and never consented to become stockholders in the American File Company, it follows that neither they nor the assets of Chapman in their hands are subject to the individual liability of stockholders for the debt of the Corporation." (*American File Co. v. Garrett*, 25 Law. Ed. (U. S.) 152).

Respectfully submitted,

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